Chartered Institute of Taxation
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Ref: CGT, ET

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Dear Martin

RDRM33170 – Remittance Basis; Collateral in respect of relevant debt

We write in respect of the change to HMRC's guidance at RDRM33170 as announced in 'What's New' on 4 August. The withdrawn version of RDRM33170 and the new version are attached as appendices 1 and 2 respectively.

Transitional issues

We note that HMRC's announcement includes a section on HMRC's position on arrangements set up before 4 August. We raise some matters of concern on this part below. However we think there is an important transitional issue that needs addressing as a matter of urgency.

Some remittance basis taxpayers will be in the process of a transaction – typically buying a UK house. They may not be in a position to obtain a conventional UK mortgage for a variety of regulatory and financial reasons. So they may – in reliance on HMRC's previous stated position – have arranged borrowing on the security of offshore funds instead of a conventional UK mortgage. The loan may not yet have been drawn down or brought into the UK, but they may already have exchanged contracts and be committed. We consider that there should be (at least) a transitional period for contracts which have already exchanged (as there usually is when changes are made to SDLT rates and thresholds for example).

Rationale for the change of view

There are certain inconsistencies in HMRC's statement of the change at http://www.hmrc.gov.uk/news/remittance-basis.htm that appear to undermine the rationale for the change.

HMRC's announcement of the change refers at paragraph 4 to the publication of a concession in 2010 in the manual at RDRM33170. Paragraph 4 states that:

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> *This concession applied to loans made on commercial terms that were regularly serviced from foreign income or gains. **In those circumstances only** the servicing payments would be taxed and not the use of the underlying collateral. (*Our emphasis*)*

This statement is not consistent with the former version of RDRM33170 (reproduced at Appendix 2 as, unhelpfully, it can only be accessed via the National Archives[1]) which stated after Example 1:

> *Note - In the example above, the relevant debt could also be serviced and repaid using non-taxable income or capital sources; in which case there would be no taxable remittances of foreign income or gains. However the servicing/repaying of the loan effectively masks the collateral offered, so there is still no remittance of the collateral in this circumstance.*

HMRC's previous view was therefore that the servicing/repayment of the loan 'masked' the collateral offered irrespective of whether the relevant debt was serviced and repaid from relevant foreign income or gains or from non- taxable income or capital sources. Under HMRC's previous practice, the only situation where collateral was treated as remitted was in cases involving avoidance or where the loan was non-commercial and payments of interest or principal were not being made at all or in token amounts such that the collateral was effectively a substitute for those payments.

The 'nudge' letters on remittances issued last year similarly state that:

> *You take out a loan from an offshore bank secured against your foreign income held by the bank and use the money to fund your life in the UK. The loan requires you to repay the capital and interest after 15 years. As the loan does not have regular monthly repayments this is a remittance of the foreign income used as security when the loan is taken out.*

There is no mention here that this treatment will only apply if the monthly repayments are from offshore funds.

Paragraph 5 of HMRC's announcement indicates that:

> *HMRC is seeing large numbers of arrangements which are not considered to be commercial and not within the intended scope of the concession. For example loans repaid from non- foreign income or gains that are not charged as a remittance, despite there being foreign income or gains collateral having been used in the UK*.

Yet the repayment and servicing of such loans from other sources such as non-taxable income or capital sources was specifically envisaged in the previous version of RDRM33170 and distinguished from non- commercial loans that were not serviced or repaid. It is difficult to see why loans repaid from non- foreign income or gains are not commercial indeed this may be the whole basis of the commercial agreement between the parties.

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[1] http://webarchive.nationalarchives.gov.uk/20140508003900/http:/www.hmrc.gov.uk/manuals/rdrmmanual/RDRM33170.htm

We also note that there was no reference in the former RDRM33170 to the stated practice being concessionary as opposed to HMRC's interpretation of the law. Indeed many commentators – see for instance *Kessler* (12th edition) at 11.18.2 - take the view that the former RDRM33170 was (broadly) and remains a good statement of the legal position.

Practical issues arising from the change of practice

1. **Form of collateral**. The former version of RDRM33170 was very helpful in practice in effectively resolving potential issues raised by the CIOT, other professional bodies and banks in 2008 in relation to what constitutes collateral. Collateral takes a number of forms from a formal security, to a deposit of title deeds, to (in some cases) simply being aware that the borrower has extensive worldwide assets and therefore taking no formal security at all (although without knowing that the assets were there the bank would not lend). At what point on this spectrum would HMRC regard the funds as 'used' outside the UK (however informally) in respect of a relevant debt?

2. **All-monies security**. A common arrangement – indeed most bank's terms and conditions contain such a provision - is where a bank has recourse to all monies and assets of the borrower in support of any borrowing. Does this change of practice mean that HMRC will now regard any income and gains in any accounts with the lending bank as a taxable remittance up to the amount of the capital loaned, together with any accrued interest?

3. **Right of set-off.** In considering whether collateral is a remittance will HMRC make a distinction between (1) monies that are available to the bank by way of set-off and (2) the charging of assets as security ?

4. **Secondary security.** In the latter case, how will HMRC approach secondary security, for example if a loan to buy a UK house is often primarily secured on that house but the bank requires a charge over non- UK assets. Can it be said that the secondary security is not used until the primary security is exhausted or is it merely notional collateral that would not constitute a remittance? We note, in particular, that at RDRM 35270 - Example 3 (Freda) it says '*in these circumstances the terms and conditions surrounding the loan and the collateral offered should be examined carefully* ***as this may prioritise the order of the accounts*** *against which any collateral charge will be taken....the s809Q(4) analysis should reflect this priority*'. Can we infer from this that collateral will be prioritised so that secondary collateral will only be taken to be used in respect of a relevant debt to the extent to which the primary security is insufficient?

   Depending upon your answer to the above, further guidance is then needed as to how one assesses which security is primary and which is secondary. Where the contractual terms specify an order of priority then presumably this will be followed? However, where - as may often be the case - there is no contractual priority will HMRC look to the purpose of the loan to assess the priority. For instance if a loan is taken out to buy a UK house and that very house is given as part of a package of security, it is natural to view the house as the primary security (even if the contractual documents do not say so) because the loan clearly relates to its purchase.

5. **Floating security** In relation to collateral and floating charges, what is the date of any remittance? ITA 2007 section 809Q(1)(b) requires **a transfer** from a mixed fund used in respect of a relevant debt. RDRM 35270 suggests that

the 'transfer' for these purposes is the original 'offering' of the security. We doubt that this is right on any normal meaning of the word 'transfer'[2]. But leaving those doubts to one side for the moment, this appears to suggest that HMRC's view is that the remittance only occurs at the point the security is initially offered. This, in turn, suggests that any subsequent changes in the assets comprised in the security would not constitute a remittance because there is no fresh 'transfer'. So, to take an example, a remittance basis user offers a particular brokerage account (comprising various shares) as collateral for a loan which is brought to the UK. The share portfolio initially consists only of shares which pre-date UK residence and are therefore clean capital. Later, after the individual is UK resident, the account is added to with dividends from those shares and capital gains from the sale of those shares. All of these are security for the original loan, but there seems to be no further 'transfer' from the mixed fund and hence no remittance. Does HMRC agree?

6. **Superfluous security**. In the latest version of RDRM 33170 you appear to take the view that the remittance is the **lower of** the foreign income or gains used as security and the amount brought to the UK. We agree that this is a sensible approach, but we cannot easily square it with section 809P(4)[3] which says that the whole of the income or gains which are used as security are so charged. On this view, to take an extreme example, a loan (brought to the UK) of £10 secured on a foreign house worth £10m could result in a remittance of £10m which is clearly nonsense. The only way to arrive at the sensible answer, however, is to interpret 'used' in such a way that collateral is only 'used in respect of' a loan to the extent to which its value does not exceed that loan and any superfluous value in the collateral is not so 'used'[4]. Does HMRC agree?

7. **Indirect security**. What view does HMRC take where the security is indirect? For instance a UK lender may make a loan to a remittance basis user. The UK lender may have a guarantee from a foreign bank (perhaps a separate company in the same banking group). That foreign bank may have assets in its accounts which represent the foreign income and gains of the individual. The individual has given no security, as such, in respect of the loan: that is given by the foreign bank. This makes it all the more difficult to see - see the comments on floating security above - that there is a 'transfer' of a mixed fund because there is no 'offering' of security by the individual at all. What view does HMRC take here? Does it depend whether both banks are in the same group? Or does it depend whether the foreign lender (in this example) takes a charge over the foreign income or gains or is merely happy to rely informally upon the monies being in that account?

8. **Combinations of the above**. We have endeavoured to itemise different issues above, but in the real world, many of the above issues will arise on a single transaction. It would not be atypical for a UK lender to lend on the strength of both a charge over the UK house and a guarantee from a foreign bank. The foreign bank has superfluous assets, comprising a mixed fund and is happy to give what may be an informal guarantee (particularly if it is in the

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[2] And we note in passing that the use of the words 'transfer of' in section 809Q(1)(b) add further weight to the argument that 'used in respect of' does not include collateral at all.
[3] Assume for these purposes that the whole proceeds of the loan are brought to the UK so that section 809P(10) is not relevant.
[4] We note again, in passing that this adds further weight to the view that 'used' really means something like 'consumed' and that HMRC's previous view of collateral is therefore correct as a matter of law and not merely of concession.

same banking group) based, in turn, upon its knowledge that it has a floating right of set-off in the very unlikely event that its secondary and superfluous security is called. In many cases such 'security' will arise not from any avoidance motive on the part of the individual (they will often be buying a UK house with a conventional UK mortgage) but from the complexity of the contractual matrix imposed by the banks.

HMRC's position on loan arrangements set up before today's date [4 August]

We think that the wording of this section of the notification of the change gives rise to uncertainty.

1. The notification says at para 6: *From today, money brought to or used in the UK under a loan facility secured by foreign income or gains will be treated as a taxable remittance of that amount of foreign income or gains.'* The phrase 'From today, money brought to … the UK…' sounds as if it only applies to new loans going forward where the money is brought to the UK from 4 August. But it is not completely clear as it also says 'From today, money …. used in the UK…' which reads as if it could apply to existing arrangements, ie those set up before 4 August but in use now. The section heading 'HMRC's position on arrangements set up before today's date ' seems to give transitional provisions for existing arrangements, implying that they are caught unless specific action is taken.

2. This section refers to two circumstances where HMRC will not take action. The first bullet says that a written undertaking has to be given (and follows with detail of what that entails). The second bullet does not mention the requirement for a written undertaking – only the repayment of the loan by 5 April 2016. Can HMRC confirm that no written undertaking of the latter has to be given? It is unclear why one requires a written undertaking and one does not.

3. When will the remittance be treated as having been made for the purposes of the tax return? That is not clear, for example is it 4 August 2014? Or when the loan was originally made, or 31/12/15 if no written undertaking has been given or 5 April 2016 if the loan has not been repaid or another date if the taxpayer tells HMRC before then that he cannot change the collateral or repay the loan.

4. While noting and welcoming that HMRC has recognised the need for some transitional period, we do feel that this may be inadequate in many circumstances. Loan-arrangements - particularly to buy houses in the UK (which will be the most common scenario) - are often long-term commitments which can easily last 5, 10, 25 years or more. In many such cases, taxpayers will have relied (via their bank) on HMRC's previous guidance and may now not be in a position to unwind the arrangements. Not all such taxpayers will be able to repay the loan as, short of selling the family home, they may have no other funds and they may not be in a position to offer additional security as they may not be able to meet the bank's requirements for this. Many bank-customers from overseas find it very difficult for regulatory reasons to obtain a conventional UK mortgage. For those in this position, the suggested transitional period is wholly inadequate.

5. Given the above, we are unclear why pre 4 August arrangements should not simply have been grandfathered rather than being given a transitional period. Or if there was to be a transitional period why it should not have been

modelled on the 25 year period in FA 2008 Schedule 7 para 90(2). A 20 month transitional period is wholly inadequate in many cases.

The way the change has been made

We regret that the change has been made without prior consultation. The benefit of early consultation with professional bodies is that at least some of the practical issues set out above could be avoided reducing collateral damage and commercial uncertainty for foreign investors.

We have previously pointed to the changes in guidance for *Mansworth v Jelley* and for Pre-Owned Assets Tax (home loans) as examples of situations where the range of circumstances may not have been fully appreciated at the time of the change to guidance. Another recent example is the revision to the treatment of specialty debts. The generic point is that if HMRC intends to change guidance significantly there is a good argument for sharing it with professional bodies (perhaps informally to start with) indicating that the issue of a revised interpretation is likely, but welcoming comments on the implications before the new interpretation is published. We do not see that informal consultation would have given rise to a risk of forestalling. Our experience is that most banks' internal tax-policies (particularly in light of the Code of Conduct for Banks) would prevent them taking forestalling measures as soon as HMRC made it clear that you were considering the position.

We fully accept and recognise HMRC’s overriding requirement to act within the law. As seen above, we are unconvinced that HMRC's previous treatment was concessionary in any event. However the law of course also includes HMRC's public law obligation, under its collection and management powers, to give effect to pre-existing legitimate expectations.

We would like to request an urgent meeting to discuss the practical implications of this announcement in order to help address the significant uncertainties. We have been in touch with various members of the British Bankers’ Association regarding this and would be happy to join with them (or indeed any other professional bodies) in any joint meeting should that be easier.

Yours sincerely

John Barnett
Deputising for Chairman, CGT & II Sub-Committee

APPENDIX 1

WITHDRAWN VERSION OF RDRM33170

RDRM33170 - Remittance Basis: Identifying Remittances: Conditions A and B: Condition B - collateral in respect of relevant debt
Example 1

Foreign income and gains may be used as collateral for a loan which is brought to the UK or otherwise used for a purpose to which ITA2007/s809L(2) applies (that is, there is a relevant debt).

Such foreign income and gains used as collateral are used 'in respect of' the relevant debt, so there may be a taxable remittance at this point.

The foreign income or gains used as collateral may be used directly, that is, the lender may receive a charge over cash assets in a bank account. However it is more likely they will be offered indirectly, often in the form of an asset such as a property or bond note that is 'derived from' the foreign income or gains.

This situation only arises where remittance basis users offer their foreign income or gains for use as collateral for a relevant debt, whether to a UK-based or an offshore lender. In many cases UK property or non-taxable offshore property is offered as collateral in respect of a relevant debts; there is no remittance of this collateral within Condition B (ITA2007/s809L(3)(c)).

To determine the amount of remittance where foreign income or gains are used as collateral in respect of a relevant debt refer to RDRM35050 Condition B - Collateral in respect of relevant debt.

Foreign income and gains used to pay interest on the debt and to repay the borrowed capital are also 'used in respect of' a relevant debt, and will be taxable as a remittance. Thus there are potentially two possible sources of a taxable remittance charge in respect of the relevant debt - the foreign income or gains used as collateral and the foreign income or gains used to repay the debt.

In the majority of commercial situations, neither party to the relevant debt transaction expects or intends that the collateral offered as security will be taken by the lender. Instead it is planned that the loan will be serviced and the capital repaid without recourse to the security charge. In such cases using foreign income or gains to regularly service or make capital repayments in respect of the relevant debt effectively 'masks' the collateral being used. In such cases the only taxable remittance will occur as and when the foreign income or gains are used to service or repay the loan. The payments, and thus the taxable remittances, will be spread over the loan period.

Example 1
In 2012/13 John, a remittance basis user takes out a loan for £200,000 from a Guernsey bank. John uses the loan to purchase a horse and a stable/paddock in Chester to indulge his young daughter's latest hobby; so the loan is a relevant debt.

John offers as collateral for the loan a 5-year offshore bond, due to mature in 2015. He purchased this bond in 2010 (a year in which he was also a UK resident remittance basis user) using £200,000 of his untaxed relevant foreign income from that year.

John repays £18,000 of the loan (principle plus interest) in 2012/13, using his relevant foreign earnings from his separate employment in Guernsey.

John is using the offshore bond as collateral for the loan; the offshore bond derives directly from his foreign income so John is using his relevant foreign income in respect of the relevant debt. However John is also using his relevant foreign earnings to both service and repay the debt capital; this 'masks' the collateral and so John will only be regarded as remitting the £18,000 Relevant Foreign Earnings in 2012/13.

Note - In the example above, the relevant debt could also be serviced and repaid using non-taxable income or capital sources; in which case there would be no taxable remittances of foreign income or gains. However the servicing/repaying of the loan effectively masks the collateral offered, so there is still no remittance of the collateral in this circumstance.

In some cases, usually involving avoidance or non-commercial arrangements, the relevant debt is not serviced or repaid by the borrower, or only a token amount is offered. In these circumstances the foreign income or gains offered as collateral are being utilised in respect of the relevant debt, that is, to delay or minimise service charges or repayments. As there is only one possible tax charge in respect of the relevant debt, that is the charge HMRC will take. The charge is taken up-front when the collateral is offered. Such arrangements are expected to be rare.

This should not be mistaken with interest-only repayment terms, or commercial arrangements that offer payment breaks and so forth. Always check the terms and general availability of the loan arrangements on offer.

If you think there is a remittance of foreign income or gains offered as collateral in respect of a relevant debt you should obtain copies of all the relevant arrangements, including all loan agreements and repayment schedules.

If you require further advice a full submission should be made to Specialist Personal Tax, PTI Advisory , Foreign Income and Remittance Basis Team.

Appendix 2 Current version of RDRM33170 (from 4 August 2014)

RDRM33170 - Remittance Basis: Identifying Remittances: Conditions A and B: Condition B - collateral in respect of relevant debt
Example 1

Foreign income and gains may be used as collateral for a loan which is brought to the UK or otherwise used for a purpose to which ITA2007/s809L(2) applies (that is, there is a relevant debt - see RDRM33160).

The foreign income and gains used as collateral are used 'in respect of' the relevant debt, so there is a taxable remittance when the loan is brought to the UK.

The collateral containing the foreign income and gains may be a charge over cash assets in a bank account or other possessions, such as property or financial instruments that are 'derived from' foreign income or gains.

This situation only arises where remittance basis users offer their foreign income or gains as collateral for a relevant debt, whether to a UK-based or an offshore lender. In many cases UK property or non-taxable offshore property is offered as collateral in respect of a relevant debt; there is no remittance of this collateral within Condition B (ITA2007/s809L(3)(c)) as the property used as collateral will not contain foreign income or gains.

To determine the amount of remittance where foreign income or gains are used as collateral in respect of a relevant debt refer to RDRM35050 Condition B - Collateral in respect of relevant debt.

Foreign income and gains used to pay interest on the debt and to repay the borrowed capital are also 'used in respect of' a relevant debt, and will be taxable as a remittance. Thus there are potentially two possible sources of a taxable remittance charge in respect of the relevant debt - the foreign income or gains used as collateral and the foreign income or gains used to repay the debt.

Example 1
In 2012-13 John, a remittance basis user takes out a loan for £200,000 from a Guernsey bank. John uses the loan to purchase a horse and a stable/paddock in Chester to indulge his young daughter's latest hobby; so the loan is a relevant debt.

John offers as collateral for the loan a 5-year offshore bond, due to mature in 2015. He purchased this bond in 2010-11 (a year in which he was also a UK resident remittance basis user) using £200,000 of his untaxed relevant foreign income from that year.

John repays £18,000 of the loan (principal plus interest) in 2012-13, using his relevant foreign earnings from his separate employment in Guernsey.

John is using the offshore bond as collateral for the loan; the offshore bond derives directly from his foreign income so John is using his relevant foreign income in respect of the relevant debt. However John is also using his relevant foreign earnings to both service and repay the debt capital; both the £200,000 foreign income from 2010-11 and the £18,000 foreign earnings from 2012-13 are regarded as remitted in 2012-13.

Note - In the example above, the relevant debt could also be serviced and repaid using non-taxable income or capital sources in which case there would be no taxable remittances of foreign income or gains in respect of the servicing payments.

If you think there is a remittance of foreign income or gains offered as collateral in respect of a relevant debt you should obtain copies of all the relevant arrangements, including all loan agreements and repayment schedules.

Note - Previous HMRC guidance did not follow the position given above and suggested that collateral in 'commercial' situations was not taxable if 'regular' servicing payments were made. This guidance was withdrawn on 4 August 2014. If you require further advice a full submission should be made to Specialist Personal Tax, PTI Advisory, Foreign Income and Remittance Basis Team.

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